United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

75-7079

75-7082

To be argued by
MARVIN SCHWARTZ

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United States Court of Appeals
FOR THE SECOND CIRCUIT

HOWARD BERSCH,

Plaintiff-Appellee,

—against—

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL & Co., LIMITED, GUINNESS MAHON & Co., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & Co. INCORPORATED, J. H. CRANO & Co., INVESTORS OVERSEAS B[illegible] LIMITED, and I.O.S., LTD.,

Defendants,

and

ARTHUR ANDERSEN & Co. and BERNARD COMFELD,

Defendants-Appellants.

CONSOLIDATED APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR THE SETTLING DEFENDANTS

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United States Court of Appeals

For the Second Circuit

Docket No. 75-7079

HOWARD BERSCH,

Plaintiff-Appellee,

against

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL AND CO., LIMITED, GUINNESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & CO. INCORPORATED, J. H. CRANG AND CO., INVESTORS OVERSEAS BANK LIMITED, I.O.S., LTD., and BERNARD CORNFELD,

Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York

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BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

Preliminary Statement

This is an appeal by defendant-appellant Arthur Andersen & Co. ("Andersen") from an order of Hon. Robert L. Carter, U.S.D.J., made December 4, 1975, which in effect determined that this action could be maintained as a class action under Rule 23(b)(3) and that plaintiff Bersch could

represent a class of 100,000 shareholders of I.O.S., Ltd. ("IOS"), a Canadian corporation, and which also approved a form of notice of class action determination, as required by Rule 23(c)(2).

The order is appealable and this Court has jurisdiction under *Herbst* v. *International Telephone and Telegraph Corp.*, 495 F.2d 1308 (2d Cir. 1974) and *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974).

A related appeal in this case (Nos. 75-7038, 75-7055 and 75-7057) (the "related appeal"), which primarily involved the issue of subject matter jurisdiction, but also presented certain class action issues also involved in this appeal, was argued on March 6, 1975, before a panel of this Court consisting of Judges Friendly, Mulligan and Timbers, and decision was reserved.*

On January 14, 1975, Andersen had moved to consolidate this appeal and the related appeal for hearing and decision, and this motion was denied by order of this Court made January 29, 1975.

On January 17, 1975, plaintiff Bersch moved to dismiss this appeal for lack of jurisdiction. This motion was denied by order dated February 19, 1975, "without prejudice to renewal at time of oral argument", scheduled for the week of May 12, 1975.

The Rule 23(c)(2) notice of class action determination, which was combined with a Rule 23(e) notice of partial settlement (287A-295A),** approved by said order of De-

* Portions of this brief will necessarily duplicate portions in Andersen's brief on the related appeal, because of the interrelationship of the facts and issues in both appeals. Since it is not now known whether this appeal will be assigned to the same panel which heard the related appeal, such repetition is unavoidable.

** On March 7, 1975, Andersen moved for leave to rely in this appeal on its three-volume Appendix filed in the related appeal. On March 19, 1975, this Court granted Andersen's motion. Accordingly, numbers with the suffix "A" refer to Appellant's Appendix in the related appeal. Additional copies have been provided for the use of the panel sitting during the week of May 12, 1975, when this appeal is scheduled for argument.

cember 4, 1974 (283A-286A), has been successively stayed by written orders of this Court made December 19, 1974 and January 7, 1975, and by a bench order made on March 6, 1975, when the related appeal was argued. The stay operates until decision on the related appeal.

Statement of the Issues Presented for Review

1. Did Judge Carter's order of December 4, 1974 in effect constitute a determination that this action may be maintained as a class action under Rule 23(b)(3), with plaintiff as the representative of the class, and also constitute his approval of the notice of class action determination required by Rule 23(c)(2)?

2. Is Judge Carter's order of December 4, 1974 appealable as of right and does this Court have jurisdiction over this appeal?

3. Should this Court, in the exercise of its supervisory control of the District Courts, set aside Judge Carter's order of December 4, 1974 as based on a champertous arrangement made in violation of law and contrary to public policy, and should this Court accordingly dismiss the class action?

4. Can plaintiff, a resident American citizen, represent a class of 100,000 purchasers of stock of a foreign corporation which did not have an office in the United States, where the stock was purchased in foreign offerings made by three prospectuses, and where 99,614, or over 99.6% of the class, consist of non-resident aliens who bought their stock abroad and 374, or 0.3% of the class, consist of non-resident Americans who were directors, officers, employees or other insiders of such foreign corporation, who also bought their stock abroad?

5. Can the District Court exercise judicial jurisdiction over some 99,614 non-resident aliens of the United States, who purchased in a large number of countries in Europe, Asia, Africa, Australia and South America, and in Canada, stock of a foreign corporation which does not have an office

in the United States, and bind such non-resident aliens to a judgment rendered by such court, because a resident citizen brought suit in such court as their representative?

6. Can a judgment rendered by the District Court be made binding on foreign class members in their native countries, especially where they are nationals of countries which do not recognize the procedures of Rule 23 and would give no recognition to such a judgment?

7. Is Rule 23(b)(3) invalid, in that it abridges and modifies substantive rights, in violation of 28 U.S.C. §2072, and extends the jurisdiction of the District Court, in violation of Rule 82?

8. Is Rule 23(b)(3) and (c)(2)(3) invalid, in that it purports to bind persons to a judgment in an action maintained as a class action, by a notice procedure which violates due process?

9. Is a class action consisting of 100,000 persons, of whom 99,614 are non-resident aliens of the United States, manageable?

Statement of the Case

Nature of the Case

This action was commenced December 9, 1971, as a class action, by plaintiff Bersch, who on September 3, 1969 bought and paid for 600 shares of common stock of IOS. The action is based on alleged misrepresentations in three separate offering prospectuses, two dated September 24, 1969, and one dated September 22, 1969, three weeks after plaintiff bought his shares. The three offerings aggregated 11,000,000 shares, at $10 a share, or a total of $110,000,000.

The complaint, which seeks recovery of $110,000,000, alleges violations of three provisions of the 1933 Act and three of the 1934 Act, including violation of Section 12 of the 1933 Act for selling securities for which a registration statement is not in effect under Section 5, and violation of

the anti-fraud provisions of both the 1933 and 1934 Acts (5A). The complaint further alleges that plaintiff is suing individually and on behalf of all persons who purchased IOS stock under the public offerings, and that "Class members are estimated to approximate 100,000 persons" (6A).

The class plaintiff thus claims to represent falls into at least three categories: (1) plaintiff alone, or possibly 11 resident Americans like plaintiff, who are IOS directors, officers, employees or other insiders; (2) some 374 non-resident Americans who bought outside the United States; and (3) some 99,614 non-resident aliens, scattered in a large number of foreign countries in Europe, Africa, Asia, Australia, South America and Canada, who bought outside the United States. This category of non-resident aliens constitutes over 99.6% of the class plaintiff purports to represent.

The complaint names as defendants the eight underwriters under three separate offerings; Andersen, described by the District Court as "an international accounting firm," which had expressed its opinion as to the IOS financial statements as of December 31, 1968 contained in each of the three prospectuses; IOS, now in the hands of a Canadian liquidator; and Bernard Cornfeld, former president of IOS.

The Course of Proceedings Below

On April 7, 1972, plaintiff moved before Judge Frankel for a Rule 23(c) order "declaring that this action can be maintained as a class suit" (48A). On June 28, 1972, Judge Frankel ruled, "but only for the preliminary purposes at hand" (81A), that the case might "proceed for the time being as a class action" (82A), but left this question "open for re-examination under Rule 23(c)(1)" (84A) after "extensive discovery" (81A).

The case was assigned to Judge Ryan for all purposes and was subsequently reassigned to Judge Carter.

Although Rule 23(c)(2) requires the Court to "direct to the members of the class the best notice practicable under the circumstances", no notice was ever sent. Plain-

tiff's counsel simply proceeded with the "extensive discovery". By order dated December [illegible], 1972 and entered on consent, it was agreed to limit plaintiff's discovery to the issues of subject matter jurisdiction, personal jurisdiction and inclusion of foreign purchasers in plaintiff's class (85A-92A).

After discovery as to the issues of subject matter jurisdiction and maintenance of the class action was complete, all defendants, including Andersen, moved on October 31, 1973 to dismiss for lack of subject matter jurisdiction or, in the alternative, to exclude from the proposed class the 99,614 non-resident aliens who bought outside the United States (107A, 110A, 150A, 159A).

On June 28, 1974, at a time when these threshold motions made October 31, 1973, were still pending without having even been argued, six of the defendants, who were the underwriters under one of the three offerings (the primary offering described below), presented to Judge Carter a proposed settlement of the $110,000,000 claim against them, in behalf of the 100,000 shareholders, for $700,000, to which plaintiff's counsel had agreed, with an indicated fee to him of $200,000 and reimbursement of $10,000 disbursements.

On July 15, 1974, Judge Carter advised counsel that he would:

> "first determine whether subject matter jurisdiction was present, advise the parties orally of its decision so that a notice of settlement could be perfected and distributed, and thereafter the court would file a written opinion explaining its holding" (254A).

Disposition in the Court Below

On July 29, 1974, without having set down for oral argument the motions made October 31, 1973, Judge Carter's chambers notified counsel orally that the Court had found subject matter jurisdiction and would approve notice of partial settlement and set a hearing on the settlement

(254A). Later, Judge Carter agreed to delay action on the proposed settlement until his written opinion was prepared.

On November 27, 1974, Judge Carter filed his written opinion explaining his reasons for sustaining subject matter jurisdiction (252A-280A), and the related appeal challenges, *inter alia,* his decision in this respect.

On December 4, 1974, Judge Carter made an order (283A) approving a notice which, as a consequence, necessarily became a part of his order. This notice, *inter alia,* stated that the District Court had "determined that the present action may be maintained as a class action on behalf of the class described above," and defined the class as "consisting of all persons who purchased the common stock of IOS in the public offering or offerings which commenced in September 1969" (288A). The notice, approved by the order of December 4, 1974, also provided for notice of the class determination which Rule 23(c)(2) requires the Court to direct to members of the class "[i]n any class action maintained under subdivision (b)(3)".

Accordingly, whatever else Judge Carter's order of December 4, 1974 may be, at a minimum it is an order determining that this action may be maintained as a class action under Rule 23(b)(3), and directing notice to members of the class, as required by Rule 23(c)(2).

As already noted, appeal was taken from this order as an appealable order under *Herbst* and *Eisen,* and the notice has been stayed until decision on the related appeal.

Statement of the Facts Relevant to the Issues Presented for Review

IOS was originally incorporated as a Panamanian corporation in 1960 and reconstituted as a Canadian corporation in June 1969, following which it maintained a registered office in Montreal. Its principal executive office was located in Geneva (56A).

On May 23, 1967, IOS and its affiliates were forbidden by SEC order from engaging in any activity subject to its jurisdiction, and were barred from making sales of securities to United States citizens or nationals wherever located, except for sales outside the United States "to officers, directors and full-time personnel of IOS and its subsidiaries" (192A-113, ¶4(i)).

In September 1969, there were three offerings of IOS stock, aggregating 11,000,000 shares, at $10 a share, or a total of $110,000,000.

The first offering was a primary offering of 5,600,000 shares, covered by a prospectus dated September 24, 1969, and underwritten by defendants Drexel Firestone, Inc. (formerly Drexel Harriman Ripley) ("Drexel"), Banque Rothschild, Hill Samuel and Co., Limited, Guinness Mahon & Co., Limited, Pierson, Heldring & Pierson, and Smith, Barney & Co. Incorporated, collectively called the "Drexel Group". The Drexel prospectus, under the heading "UNDERWRITING", lists 122 underwriters and dealers in 14 countries in Europe. Japan and Australia, in which they were located and where they intended to sell IOS stock (175A-176A). Each of these 122 underwriters and dealers was strictly bound by contractual provisions reflected in a legend appearing on the front page of the Drexel Group prospectus, which stated that the shares were not registered under the United States Securities Act of 1933, and were not being offered in the United States, or to nationals, citizens or residents of the United States (168A).

The restrictions against sales to American citizens or residents were fully observed. No shares were sold to anyone in the United States, or to an American citizen regardless of residence. Sales were limited to non-resident aliens in Europe, Asia and Australia. Judge Carter expressly found, with respect to the Drexel Group, that "no sales to Americans did occur" (268A).

The 1,450,000 shares under the Crang secondary offering, dated September 22, 1969, were subject to the same

rigid restrictions to insure that sales were limited to Canada, and that no sales would be made to American citizens (63A-71A). Here, too, the District Court found that the restrictions were effective, and that "Crang did not sell I.O.S. shares to any American citizen, [and] took precautions to prevent and placed restrictions on the sales to Americans" (274A).

The IOB prospectus, dated September 24, 1969, which was for 3,950,000 common shares, also made it clear that IOS shares were not being offered in the United States, though sales were authorized to officers, directors, employees and other insiders of IOS under the SEC order. While Judge Carter found that 386 American citizens bought under the IOB offering, recognizing that they were either IOS employees or other insiders (256A), there has been no indication that anyone bought his shares in the United States.

Since the three offerings were of shares of a foreign corporation effected entirely outside the United States, with sales limited to non-resident aliens (except for such limited exception under the IOB prospectus), the offerings were not registered under the 1933 Act. The facts as to all three offerings were presented in advance to the SEC, which took no action to prevent sales because of such non-registration.

Plaintiff, who worked directly under Robert Sutner, an IOS director and senior advisor to its sales organization (172A), apparently learned of the public offering and on September 3, 1969,—21 days before the date of any of the three prospectuses,—wrote Juanita C. Torres, 119 Rue d'Lausanne, Geneva, an IOS employee, and subscribed for 600 shares at $10 a share, enclosing a cashier's check in payment (47A-1).

Plaintiff did not buy under the Drexel or Crang prospectus, since as Judge Carter found, "no sales to Americans did occur through the Drexel Group or Crang offerings" (268A). It is not even clear that plaintiff bought under the IOB prospectus, since he bought on September 3, 1969,

by direct subscription to IOS, in Geneva, whereas the IOB prospectus was dated September 24, 1969, three weeks later, in the Bahamas.

Judge Carter also found that "plaintiff's purchase of I.O.S. shares does not appear to have been made in reliance on statements in the Crang prospectus, since that prospectus was sent to the United States after the date of the purchase" (273A). Such non-reliance would necessarily apply to all three prospectuses, all dated three weeks after plaintiff's purchase.

Plaintiff conceded in his Answers to Interrogatories (Ans. to No. 23(b)) that when he bought on September 3, 1969, he was "aware of a consent order regarding I.O.S., Ltd. entered by the Securities and Exchange Commission on May 23, 1967" (34A, 44A). Accordingly, if plaintiff, in fact, bought his shares in the United States, as he appears to claim, he would have done so with knowledge that this would violate the SEC order which, though expressly authorizing sales to IOS insiders, prohibited sales within the United States. However, it is not clear that the sale to plaintiff was made in the United States and, as suggested by Judge Friendly on the oral argument of the related appeal, it could well have been accomplished abroad.

THE ARGUMENT

POINT I

Judge Carter's order of December 4, 1974 constituted a determination that this action may be maintained as a class action under Rule 23(b)(3), with plaintiff as the representative of a class consisting of 100,000 IOS stockholders, 99.6% of whom are non-resident aliens who purchased their shares in various countries in Europe, Asia, Australia, Africa and South America, and in Canada.

Judge Carter's order of December 4, 1974 also approved the giving of notice to all members of the class, as required by Rule 23(c)(2).

According to plaintiff, Judge Carter's order of December 4, 1974 did not make a class action determination under Rule 23(c), but, as claimed in his attorney's affidavit in support of dismissal of this appeal, is merely "an order setting forth certain procedural steps to be taken in connection with a proposed partial settlement entered into by plaintiff with certain of the defendants, other than Andersen" (aff. 1/17/75, p. 2).

However, Judge Carter's order may not be viewed in a vacuum as though unrelated to the provisions of the notice which it approved. Such notice is an integral part of his order.

Such notice, referring to the alleged class of 100,000 IOS stockholders, states that the District Court had "determined that the present action may be maintained as a class action on behalf of the class described" in the notice. The notice describes the class as "consisting of all persons who purchased the common stock of IOS in the public offering or offerings which commenced in September 1969" (288A). If a class action determination has been made, as the notice so clearly states, then some judge must have made it.

Judge Frankel, as already noted (p. 5, *supra*), ruled "but only for the preliminary purposes at hand" (81A),

that the case should "*proceed for the time being* as a class action" (82A).

Judge Ryan, to whom this case was first assigned for all purposes, felt that Judge Frankel had not made a class action determination. He stated unequivocally that Judge Frankel "didn't enter any class order. He defined no class * * *. Therefore, what he said was dictum" (192A).

Since Judge Carter's order approved a notice which described the class action determination as having been made on June 28, 1972, he appears to differ with Judge Ryan's view, and apparently regarded Judge Frankel's decision as a class action determination, even though, as Judge Ryan so bluntly stated, Judge Frankel "didn't enter any class order" and "defined no class."

The applicable circumstances establish the correctness of Judge Ryan's position. Had Judge Frankel intended to make a Rule 23(c)(1) class determination, a prompt (c)(2) notice to all members of the class was an essential prerequisite. *Eisen* v. *Carlisle & Jacquelin, supra,* 417 U.S. 156, 176, 178 (1974) stressed what is self-evident on the face of Rule 23; namely, that notice to all members of the class is "an unambiguous requirement of Rule 23," which must be complied with "'[a]s soon as practicable after the commencement of [the] action.'" That Judge Frankel was mindful of this is evident from his statement that "The keystone * * * is the matter of notice under subdivision (c)(2) of Rule 23" (84A).

Any conceivable doubt as to the correctness of Judge Ryan's view of Judge Frankel's order was dispelled by the Supreme Court's decision on February 18, 1975, in *Board of School Commissioners* v. *Jacobs,* 43 L.W. 4238 (not yet reported in the advance sheets), where the District Court's statement as to a class was as generalized as Judge Frankel's statement and where, as here, there was no order certifying a class, and a class order notice had not been prescribed. In *Board of School Commissioners,* no one in the District Court or in the Court of Appeals (*Jacobs* v.

Board of School Commissioners, 490 F.2d 601 (7th Cir. 1973)) had apparently questioned the District Court's statement as being a class action determination. The Supreme Court, however, questioned it *sua sponte,* and found "inadequate compliance with the requirements of Rule 23(c)," stating (43 LW 4238-9):

> "The only formal entry made by District Court below purporting to certify this case as a class action is contained in that court's 'Entry on Motion for Permanent Injunction,' wherein the court 'conclude[d] and ordered' that *'the remaining named plaintiffs are qualified as proper representatives of the class whose interest they seek to protect.'** 349 F. Supp., at 611. No other effort was made to identify the class or to certify the class action as contemplated by Rule 23 (c)(1); nor does the quoted language comply with the requirement of Rule 23 (c)(3) that '[the] judgment in an action maintained as a class action under the subdivision . . . (b)(2) . . . shall include and describe those whom the court finds to be members of the class.' * * * Because the class action was never properly certified nor the class properly identified by the District Court, the judgment of the Court of Appeals is vacated and the case is remanded to that court with instructions to order the District Court to vacate its judgment and to dismiss the complaint."

If, as is so clear from *Board of School Commissioners* v. *Jacobs,* and all the applicable circumstances, Judge Frankel's order of June 28, 1972 was not a class determination under Rule 23, then the only order which could be deemed a class action determination is Judge Carter's order of December 4, 1974, approving the notice.

Once a District Court has determined under subdivision (c)(1) that an action may be maintained as a (b)(3) class action, then Rule 23(c)(2) mandates that the class action notice be directed to the members of the class. Rule 23 (c)(2) requires that the "notice shall advise each member" of the class of three things, described under subsections

* Unless otherwise noted, italics throughout have been supplied.

(A), (B) and (C). The notice directed by Judge Carter separately covers each of these subsections, even tracking their language, as shown by the following:

The notice must advise that:

> "(A) the court will exclude him from the class if he so requests by a specified date."

The notice approved by Judge Carter's order advises that:

> "Any member of the class will be excluded from the class if he so requests in writing received by the Clerk of this Court on or before March 6, 1975" (288A).

The notice must also advise that:

> "(B) the judgment, whether favorable or not, will include all members who do not request exclusion."

The notice approved by Judge Carter's order advises that:

> "any judgment in this action, whether or not favorable to the plaintiff class, will include all members who do not request exclusion from the class and will be binding upon all class members who do not so request exclusion" (288A).

Finally, the notice must advise that:

> "(C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel."

The notice approved by Judge Carter's order advises that:

> "Any member of the class who does not request exclusion from the class may, if he desires, enter an appearance through his counsel" (288A).

The notice approved by Judge Carter's order of December 4, 1974 thus clearly purports to be a notice under Rule

23(c)(2),—which is applicable only where a court has made a (b)(3) class action determination under Rule 23(c)(1),—and accordingly, such notice meticulously covers each of the three separate requirements of a (c)(2) notice.

If, as shown above, Judge Frankel had not made the class action determination, then it had to be Judge Carter, the only Judge who ever directed that a (c)(2) notice be given to members of the class.

POINT II

Judge Carter's order of December 4, 1974 determining that this action may be maintained as a class action is an appealable order and this Court therefore has jurisdiction over the appeal.

This Court, in *Eisen* v. *Carlisle & Jacquelin,* 479 F.2d 1005 (2d Cir. 1973) (commonly called "Eisen III"),—applying the "collateral order" doctrine of *Cohen* v. *Beneficial Industrial Loan Corp.,* 337 U.S. 541 (1949),—held that "An order sustaining a class action allegation clearly involves issues 'fundamental to the further conduct of the case' " (citing four Supreme Court decisions) (p. 1007, fn. 1), and is therefore appealable.

In *Herbst* v. *International Telephone and Telegraph Corp.,* 495 F.2d 1308 (2d Cir. 1974), where, as in this case, the defendant was "appealing from an order holding that a class action can be maintained", this Court stated:

> "Although other courts of appeals have held that orders authorizing class actions are not appealable, we believe that *Eisen III* reached the correct result and we adhere to it * * *. We believe that immediate review of orders authorizing class actions will aid the district courts in disposing of these cases and promote the sound administration of justice" (p. 1312).

* * *

> "We believe that in the exercise of our supervisory powers over the administration of justice in the district courts it is desirable for us to review orders authorizing class actions before the parties in the district courts expend large amounts of time and money in managing them" (p. 1313).

In *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974), the Supreme Court agreed with this Court's decision in *Eisen III* that it "had jurisdiction to review the District Court's orders *permitting the suit to proceed as a class action.*" Thus, the Supreme Court held (pp. 169-170):

> "At the outset we must decide *whether the Court of Appeals in Eisen III had jurisdiction to review the District Court's orders permitting the suit to proceed as a class action* and allocating the cost of notice. Petitioner contends that it did not. Respondents counter by asserting two independent bases for appellate jurisdiction: *first, that the orders in question constituted a 'final' decision within the meaning of 28 U.S.C. §1291 and were therefore appealable as of right under that section;* and, second, that the Court of Appeals in *Eisen II* expressly retained jurisdiction pending further development of a factual record on remand and that consequently no new jurisdictional basis was required for the decision in *Eisen III*. Because *we agree with the first ground asserted by respondents,* we have no occasion to consider the second."

Accordingly, on the basis of *Herbst* and *Eisen III* in this Court, and *Eisen* in the Supreme Court, the order of December 4, 1974 determining that this action should be maintained as a class action and prescribing the (c)(2) notice to be sent to all members of the class is clearly appealable.

Plaintiff's counsel has from time to time urged varying reasons why this order may not be appealable. Rather than anticipate the particular argument he may now make on this appeal, we will await his brief and in our reply brief make appropriate response.

POINT III

This Court, in exercise of its supervisory control of District Courts, should set aside Judge Carter's order of December 4, 1974 as based on a champertous arrangement made in violation of law and contrary to public policy, and should dismiss the class action.

LaBuy v. *Howse Leather Co.*, 352 U.S. 249, 259-60 (1957) reaffirmed that "supervisory control of the District Courts by the Courts of Appeal is necessary to proper judicial administration in the federal system". When this Court, in *Herbst* v. *International Telephone and Telegraph Corp.*, *supra*, 495 F.2d 1308, 1313 (2d Cir. 1974), referred to the desirability that it "review orders authorizing class actions," it related such review to "the exercise of our supervisory powers over the administration of justice in the district courts."*

Eisen v. *Carlisle & Jacquelin*, 417 U.S. 156, 178-9 (1974) held that a Rule 23(c)(2) notice is part of a plaintiff's cost in bringing a class action:

> "The usual rule is that a plaintiff must initially bear the cost of notice to the class. * * * Where, as here, the relationship between the parties is truly adversary, the plaintiff must pay for the cost of notice *as part of the ordinary burden of financing his own suit.*"

The "cost of notice to the class" is thus as much a part of "the ordinary burden of financing his own suit" as the cost of filing the complaint, the cost of transcripts of depositions and other out-of-pocket disbursements.

Under the *Code of Professional Responsibility*, regardless of who may advance disbursements, "the ultimate liability for such costs and expenses must be that of the client" (EC-5-8); "the client remains ultimately liable for such expenses" (DR 5-103(B)).

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* See also, *Burton* v. *United States*, 483 F.2d 1182, 1187-8 (9th Cir. 1973), citing innumerable cases as to the duty of the Courts of Appeals in "exercising our supervisory power, to assure that there be the strictest compliance with the requirements" of the Federal Rules.

In *General Motors Corp.* v. *City of New York,* 501 F.2d 639, 643, fn. 11 (2d Cir. 1974), this Court reaffirmed that such disciplinary rules are " 'mandatory in character . . . [and] state the minimum level of conduct below which no lawyer can fall.' " This Court also stressed that it has "inherent power to assure compliance with these prophylactic rules of ethical conduct."

In *Matter of Gilman,* 251 N.Y. 265, 269 (1929), Chief Judge Cardozo held that an agreement whereby an "attorney bound himself * * * to pay the expenses of proceedings to enforce his client's rights" is "a champertous agreement,"—a holding equally applicable to payment by a third party.

Since, under *Eisen,* plaintiff Bersch "must pay for the cost of notice as part of the ordinary burden of financing" this suit, any advance of the cost of a (c)(2) notice must necessarily be on the unequivocal basis that Bersch "remains ultimately liable for such expenses" (DR 5-103 (B)), —whether the advance is made by his lawyer or by a third party, including the very defendants being sued by plaintiff. An agreement by defendants in a class action to assume for plaintiff the cost of his (c)(2) notice which is "part of the ordinary burden of financing his own suit," is particularly reprehensible if part of the *quid pro quo* is plaintiff's agreement to settle his claim against such defendants.

Plaintiff's brief in the related appeal,—referring to the Rule 23(c)(2) notice to members of the class as defined in his complaint,—candidly acknowledged that he had no intention of paying the cost of the (c)(2) notice, and that he had arranged for certain of the defendants to bear this cost. As there stated:

> "In addition, the Supreme Court's decision in *Eisen* v. *Carlisle & Jacquelin,* 417 U.S. 156 (1974), decided after commencement of this action, which determined that plaintiff must bear the cost of giving

personal notice, would have imposed upon plaintiff a burden of approximately $50,000 to give the required notice. Such a burden was clearly beyond plaintiff's means and the Settling Defendants' agreement to bear that burden *made it possible for this action to proceed against the remaining defendants* whom plaintiff believes to be the principal wrongdoers in the action" (p. 12, fn.).

Eisen also held that a plaintiff unwilling to "bear the cost of notice under subdivision (c)(2)" will have his class action dismissed. Therefore, if the cost to plaintiff Bersch of notice to the class will be $50,000, and he is unwilling to bear this cost, as he has acknowledged in the above quotation from his brief, then Andersen has a right to dismissal. This right cannot be circumvented by plaintiff having defendants agree to pay the cost of the (c)(2) notice,—an arrangement void as champertous.

The procedure here followed offers special opportunity for collusive settlements of class actions. Plaintiff Bersch, unwilling to pay the $50,000 cost of notice to the class, had two alternatives, dismissal or payment by someone else. Anyone paying such cost would necessarily want his *quid pro quo*. Here, the *quid pro quo* is a settlement favorable to those paying the cost of the (c)(2) notice to the class. Plaintiff could thereby surmount the hurdle of the $50,000 cost of notice to the class, and enable his action to proceed against Andersen and the other non-settling defendants.

The taint is here particularly reprehensible where settlement of a $110,000,000 claim is being made for $700,000, with a $200,000 indicated fee for plaintiff's attorney and reimbursement to him of $10,000 expenses, so that the fund available to the class is merely ½% of the claim.

It is no answer to suggest that a settling defendant can pay the cost of a Rule 23(e) notice and that little, if any, additional expense may be involved in combining it with a (c)(2) notice. The taint remains.

Assume that the settlement is not approved by the District Court, there is no agreement by plaintiff to reimburse defendants for the $50,000 cost of the notice. Plaintiff would remain as the class representative and would have succeeded in having others pay the $50,000 cost, which is part of his "ordinary burden of financing his own suit."

Judge Friendly, in *Saylor* v. *Lindsley*, 456 F.2d 896, 900-901 (2d Cir. 1972), realistically described the inherent "conflict of interest" in what he called "simple recognition of the facts of class action life." Judge Friendly there noted the conflict of interest in which a lawyer representing a class action plaintiff is necessarily involved, and perhaps this is inevitable from the very nature of a class action and the manner in which Rule 23 is designed to force settlements.* This problem is compounded when, in addition to the "conflict of interest" alluded to by Judge Friendly in *Saylor* v. *Lindsley*, there is the further conflict of a plaintiff class representative unwilling to pay "the ordinary burden of financing his own suit," who settles with certain defendants willing to relieve him of such burden. This added conflict should not be permitted to become part of "the facts of class action life."

Plaintiff's brief in the related appeal states as a possible excuse that *Eisen* was "decided after commencement of this action." However, the relevant date is not when this action was commenced, but when plaintiff made his settlement.

Eisen was decided by the Supreme Court on May 28, 1974. The settling defendants had for some time been seeking to settle the case, but in the period of two years and four months between commencement of this action and the decision in *Eisen* apparently got nowhere. However, a month after *Eisen* was decided, plaintiff and the settling defendants had already signed the Stipulation of Settlement, dated June 28, 1974 (244A-251A). The inference is inescapable that it was *Eisen* that enabled a settlement for

* See Friendly, *Federal Jurisdiction, a General View* (1972), pp. 119-20.

about ½% of the claim and that plaintiff, to avoid paying $50,000 as the cost of the (c)(2) notice to the class, made a deal for some defendants to pay the cost of such notice, as part of a "sweetheart" settlement. Plaintiff could then seek additional balm from Andersen, the international accounting firm known to be financially responsible and amply insured, without any payment of "the ordinary burden of financing his own suit".

The fact that the settling defendants agreed to pay the $50,000 cost of the (c)(2) notice to class members is obviously a highly relevant condition of the settlement. However, it was not disclosed in the 8-page Stipulation of Settlement (244A-251A), or in the 9-page notice to class members (287A-295A),--a notice which discloses the intent to seek reimbursement of "disbursements and expenses incurred on behalf of the class" of approximately $10,000 (294A).

Candor clearly compelled disclosure in both the Stipulation of Settlement and in the notice to class members that, without this settlement, plaintiff could not proceed with the action because unwilling to pay the $50,000 cost of the (c)(2) notice; and that under the proposed settlement, the settling defendants had agreed to pay this cost, without any obligation on plaintiff's part to reimburse them if the settlement were not approved.

While plaintiff may argue that these are matters for consideration by Judge Carter when the merits of the settlement are presented to him for approval, they relate to the basic "facts of class action life" and the functioning of the judicial process. This Court, in exercise of its "supervisory control of the District Courts" should rectify this situation at the outset and assure "proper judicial administration in the federal system".

Since the commitment on the part of the settling defendants to pay for $50,000 cost of the (c)(2) notice is a void, champertous arrangement, and since plaintiff has made it so clear that he himself will not pay for the cost of such notice, then, under *Eisen,* this action should be dismissed.

POINT IV

The 99,614 non-resident aliens who purchased their IOS stock abroad cannot meet the jurisdictional requirements of a suit in the District Court. Accordingly, under *Snyder* v. *Harris* and *Zahn* v. *International Paper*, they may not be members of a class subject to the jurisdiction of the District Court.

A. The 99,614 Foreign Purchasers Have No Cause of Action Under the American Securities Laws and Could Not Bring Their Own Action in the District Court.

Accordingly, Under *Snyder* v. *Harris* and *Zahn* v. *International Paper*, They May Not Be Included in Plaintiff's Alleged Class.

Snyder v. *Harris*, 394 U.S. 332 (1969),—which held that separate claims for various claimants in a class action may not be aggregated to meet the jurisdictional amount,—reaffirmed that Rule 23, as amended in 1966, could not extend jurisdiction to a claim over which the District Court would have had no jurisdiction before such 1966 amendments.

Zahn v. *International Paper Co.*, 414 U.S. 291, 301 (1973) held that a plaintiff in a class action who satisfied the requisite diversity and jurisdictional amount could not include in the alleged class anyone who lacked the jurisdictional amount:

> "Each plaintiff in a Rule 23(b)(3) class action must satisfy the jurisdictional amount, and any plaintiff who does not must be dismissed from the case—'one plaintiff may not ride in on another's coattails.' 469 F.2d at 1035".

Zahn was not referring to named plaintiffs, since each "was found to satisfy the $10,000 jurisdictional amount". *Zahn* related solely to class members whose claims were

less than the jurisdictional amount. The Court read *Snyder* v. *Harris, supra,* "as precluding maintenance of the action by any member of the class whose separate and distinct claim did not individually satisfy the jurisdictional amount" (414 U.S. at 292).

In short, the essence of *Zahn* is that a person who cannot sue in the federal courts as a named plaintiff because of lack of jurisdiction over his claim, may not be part of a class represented by a named plaintiff over whose claim the federal court has jurisdiction.

This Court will recall that under former Rule 23(a)(3), there were three categories of class action,—the true class action, the hybrid class action and the "spurious" class action.

The complaint (¶2) alleges:

> "(b) This action can be maintained as a class action *pursuant to Rule 23(b)(3)* of the Federal Rules of Civil Procedure."

Rule 23(b)(3), as amended in 1966, covers the previous "spurious" class action; some courts continue to refer to a Rule 23(b)(3) litigation as a "spurious" class action. See, for example, *La Mar* v. *H & B Novelty & Loan Co.,* 489 F.2d 461, 467 (9th Cir. 1973).

Moore describes Rule 23(b)(3) as "the mod version of the spurious class action of yore" (Moore's *Federal Practice,* 2d ed., Vol. 3B, ¶23.45[1], p. 701). Elsewhere, Moore states:

> "The lineal descendant of the spurious class action under original Rule 23 is the (b)(3) type of class suit under revised Rule 23" (*Id.* at 2601).

Zahn,—quoting *Steele* v. *Guaranty Trust Co. of N.Y.,* 164 F.2d 387, 388 (2d Cir. 1947),—stated as to the "spurious" class action (p. 296):

> "The spurious class action authorized by Rule 23(a)(3), as it stood prior to amendment in 1966, was viewed by Judge Frank, writing for himself and

> Judges Learned and Augustus Hand, as 'in effect, but a congeries of separate suits *so that eacl claimant must, as to his own claim, meet the jurisdictional requirements.*' "

Zahn governs the suit at bar.

The issue is thus whether each of the 99,614 non-resident aliens who bought stock from alien underwriters or sellers in Europe, Africa, Asia, Australia and South America and Canada, and who constitute over 99.6% of the putative class of 100,000, can "*as to his own claim, meet the jurisdictional requirements,*" so that he could commence his own suit in the federal court under the 1933 and 1934 Acts. If he cannot, then under the clear holding of *Zahn,* there is no federal jurisdiction as to him in a class action brought by plaintiff, even assuming jurisdiction over plaintiff's own claim. Again, to quote *Zahn,* which in turn quoted this Court's decision in *Steele* v. *Guaranty Trust Co. of N.Y.,* each of such 99,614 non-resident alien purchasers " 'must, as to his own claim, meet the jurisdictional requirements.' "

Zahn is not limited to diversity actions; the Court there stated:

> "[T]he result here would be the same even if a cause of action under federal law could be stated, see *Illinois* v. *City of Milwaukee,* 406 U.S. 91, 98-101 (1972), or if substantive federal law were held to control the case" (414 U.S. at 302, fn. 11).

The basic issue, therefore, is whether the 99,614 non-resident aliens, who bought outside the United States; who bought somewhere in Europe, Africa, Asia, Australia or South America, from a non-resident alien underwriter; and who paid for and received their stock in such foreign country could each, "as to his own claim, meet the jurisdictional requirements" for an action in the United States District Court for alleged violation of the American securities laws.

This Court, on the oral argument in *Leasco Data Processing Equipment Corp.* v. *Maxwell,* 468 F.2d 1326, 1338

(2d Cir. 1972), found it helpful to illustrate and analyze the jurisdictional issue by postulating a hypothetical case involving a Japanese and a German businessman,—an approach which might here also be helpful.

Take, as an example, a Japanese resident of Tokyo who, like plaintiff, acquired 600 shares of IOS stock for $6,000, which he had bought from The Nikko Securities Co. Ltd., a Japanese underwriter (175A). Assume that he received all three prospectuses, either in English or in one of the foreign languages in which the Drexel prospectus was translated, and that he read all three prospectuses and relied on them before he bought.

(1) Such Japanese investor would then know from such prospectuses that IOS is a Canadian company, with its main office in Geneva, and that it has no office in the United States.

(2) He would see that each prospectus states that the offering is not subject to the American securities laws, and therefore has not purported to meet their requirements.

(3) He would know that sales under the Drexel prospectus can be made only to nationals of Europe, Africa, Asia, Australia and South America, provided they reside outside the United States or its territories.

(4) He would also know that sales to United States citizens anywhere in the world or to foreigners in the United States, were prohibited.

(5) He would also know from the Drexel prospectus that there are 91 underwriters, in 13 countries in Europe, Africa, Asia, Australia and South America, and that each of them, including his seller, The Nikko Securities Co. Ltd., had agreed not to sell any IOS stock to any United States citizen anywhere in the world and not to sell to any alien who resides in the United States.

(6) He would also know that there was a separate offering made by the Canadian underwriter, Crang, who was

expressly prohibited from selling IOS stock outside Canada, and who agreed to abide by such express restriction.

(7) He would also know that in 1967, the SEC issued an order which prevented sale of ICS stock within the United States, and also prohibited sale of IOS stock to a non-resident United States citizen unless he was an IOS employee or other insider.

(8) He would also know that there was a separate offering made by IOB, a Bahamas bank, which is an IOS subsidiary, but that such offering was limited to such insiders, as authorized by the SEC order, and that sales under this offering could not be made in the United States, and he would also know that this Bahamas bank had agreed to abide by such express restriction.

(9) He would also know that the prospectuses, dated September 24, 1969, include financial statements, as of December 31, 1968, as to which Andersen's Zurich office had expressed an opinion.

(10) He would also know that the IOS stock is not listed or traded on any stock exchange in the United States, and is not traded over the counter in the United States.

(11) He would also know, from his own transaction, that he paid The Nikko Securities Co. Ltd. for his stock in Tokyo and received his stock in Tokyo.

(12) He would also know that, in making his purchase, neither he nor The Nikko Securities Co. Ltd. used the United States mails or any instrumentalities of interstate commerce of the United States in connection with the purchase or sale of such 600 IOS shares.

This Japanese investor, having lost his entire $6,000 investment, may feel that he was misled by the financial statements in the prospectuses as to which Andersen had expressed an opinion.

Such Japanese investor, with only a $6,000 investment, could not sue Andersen in the District Court on diversity jurisdiction, since he lacks the requisite amount in controversy. Could he, as a non-resident alien, assert protec-

tion of the American securities laws as to which there is no "matter in controversy" requirement?

Since such Japanese and each of the other 99,613 foreign buyers " 'must, as to his own claim, meet the jurisdictional requirements', *Steele* v. *Guaranty Trust Co. of N.Y.*, 164 F.2d 387, 388 (C.A.2d 1947)" (*Zahn* v. *International Paper Co.*, 414 U.S. at 296),—which he obviously fails to do,—he may not be represented in a class action by a claimant such as plaintiff, who may "individually satisfy the jurisdictional requirements".

B. The District Court Lacks Judicial Jurisdiction to Bind to a Judgment 99,614 Non-Resident Aliens by Mere Notice Mailed to Their Last-Known Address.

Leasco noted that, despite the most expanded scope to be given to §27 of the 1934 Act, the due process clause necessarily applies to efforts to bind foreigners: "[W]e hold that Congress meant §27 to extend personal jurisdiction to the full reach permitted by the due process clause" (468 F.2d at 1339). Also, "Congress meant to assert personal jurisdiction over foreigners not present in the United States to but, of course, not beyond the bounds permitted by the due process clause of the Fifth Amendment" (p. 1340).

Then, after review of *Hanson* v. *Denckla*, 357 U.S. 235 (1958) and other authority, *Leasco* stated that where a person "has acted within a state or sufficiently caused consequences there, he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state" (*Id.*).

Due process considerations as to class action were not and could not be repealed by Rule 23. The Advisory Committee Notes recognize that any notice must "fulfill requirements of due process to which the class action procedure is of course subject" (39 F.R.D. 69, 107). *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 173-4 (1974), quoted this state-

ment of the Advisory Committee, and noted its purpose of "incorporation of due process standards".

As more fully developed below (Points V, VI),—in showing that Rule 23 illegally abridges and modifies a "substantive right", contrary to 28 U.S.C. §2072, and extends the jurisdiction of the District Court contrary to Rule 82,—a basic change accomplished by Rule 23(b)(3) and (c)(3) is to include in the judgment in a class action "whether or not favorable to the class", those to whom a class action notice was sent and "who have not requested exclusion". As Moore put it, the effect of Rule 23(b)(3) is "the expansion of the reach of the judgment, which now binds all members of the class who do not exclude themselves" (3B J. Moore, *Federal Practice* ¶23.45[1], at 23-702 (2d ed. 1974)).

Rule 23 applies to all members of a class, whether a plaintiff class or a defendant class. It does not purport to distinguish between plaintiff or defendant members, or those within or without the United States. Under its language, a mere notice suffices to bind to a judgment, whether favorable or unfavorable, each person to whom the notice is addressed, whether or not the notice is actually received.

There is no requirement that a recipient of the notice who is "not present within the territory of the forum", but is nevertheless to be bound by the judgment, should "have certain minimum contacts with it" (*International Shoe Co.* v. *Washington,* 326 U.S. 310, 316 (1945)). There is no requirement that such recipient of the notice purposely avail himself "of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws" (*Hanson* v. *Denckla,* 357 U.S. 235, 253 (1958)).

There is no requirement that such recipient of the notice "has acted within a state or sufficiently caused consequences there, [that] he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state" (*Leasco,* 468 F.2d at 1340).

While *International Shoe, Hanson* and *Leasco* were not addressed to a class action notice, but to process in ordinary litigation, due process principles there stated should apply *a fortiori* to a mere notice. Both the process and the notice have the same purpose,—to bind a person to a judgment. Indeed, the standard for process might be more rigidly applied to a mere printed notice than to formal process in a lawsuit. A person receiving a summons or other formal process, especially if sent by certified mail or personally served outside the forum, is more apt to be impressed with its significance and need for response, than he would be as to a mere printed notice by ordinary mail, which might resemble much of the routine, throwaway matter normally received in quantities, and he might be less apt to appreciate the full significance of the notice.*

Judge Frankel has indicated the possible lack of due process involved in a mere notice or newspaper publication:

> "To a generation raised on Pennoyer v. Neff, 95 U.S. 714, 24 L.Ed. 565 (1877), it is a rather heady and disturbing idea to be told that people in faraway places

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* Illustrative of the inability of members of a class to understand the significance of a printed notice are the responses received from members of the class in the Antibiotics case. A collection of some of the responses to the notices sent out by mail in North Carolina appears in *"Processing the Consumer's Claim"*, ABA Antitrust L.J., vol. 41, 257, 267.

> "Dear Mr. Clerk: I have your notice that I owe you $300.00 for selling drugs. I have never sold any drugs, especially those that you have listed. I have sold a little whiskey once in a while though."
>
> "Dear Mr. Clerk: I would like to know why I am a party to this action that I don't know nothing about. Who made me a party to anything? (I am a democrat.)"
>
> "Dear Sir: Our son Bill is in the Navy stationed in the Caribbean some place. Please let us know exactly what kind of drugs he is accused of taking. From a mother who will help if properly informed. A worried mother Jane Doe."
>
> "Dear Mr. Morgan: I received your card about the lawsuit and I would like to know how much I owe and can I pay it off by the month so I won't have to go to court? If I can pay by the month, I will do just that as soon as I hear from you."

who receive a letter or are 'described' in a newspaper 'notice' which does not come to their attention are exposed to a binding judgment unless they take some affirmative action to exclude themselves". ("Some Preliminary Observations Concerning Civil Rule 23", 43 F.R.D. 39, 45 (1967)).

Perhaps, because of nationwide service under the securities acts, mere notice sent anywhere in the United States might satisfy "due process". But there is no comparable provision in the securities acts for worldwide service. And this Court has only recently stated that the constitutional requirement of "minimal contacts" for service outside the forum, though not applicable to United States residents because of nationwide service under the 1934 Act, would be required for "extraterritorial service of process", which "raises a question of the forum's power to assert control over the defendant." *Mariash* v. *Morrill*, 496 F.2d 1138, 1143 (2d Cir. 1974).

Accordingly, it would appear clear that the District Court cannot, by merely mailing a notice, make the 99,614 non-resident aliens of the United States members of a class subject to its authority, or exercise what *Leasco* called "judicial jurisdiction over an individual who is not present."

C. To Allow the 99,614 Non-Resident Aliens to Be Members of a Class in an Action Brought in the United States Would Frustrate the Intent of Rule 23, as Amended in 1966, to Eliminate One-Way Intervention.

Under former Rule 23(a)(3) where only persons who actually intervened were bound by the judgment, "one-way intervention" resulted. Courts held that after a class representative prevailed on the merits, others could intervene and take the benefits. But, if the decision was unfavorable, they could remain outside the case and relitigate in another forum. As stated in the Advisory Committee Notes on the 1966 Amendments:

"Hitherto, in a few actions conducted as 'spurious' class actions and thus nominally designed to extend only to parties and others intervening *before* the determination of liability, courts have held or intimated that class members might be permitted to intervene *after* a decision on the merits favorable to their interests, in order to secure the benefits of the decision for themselves, although they would presumably be unaffected by an unfavorable decision. * * * Under proposed subdivision (c)(3), one-way intervention is excluded; the action will have been early determined to be a class or nonclass action, and in the former case the judgment, whether or not favorable, will include the class, as above stated." (Emphasis in original) (39 F.R.D. 105-6).

American Pipe & Construction Co. v. *Utah,* 414 U.S. 538, 547 (1974), referred to the unfairness of such "potential for so-called 'one-way intervention' ", which it described as a "recurrent source of abuse", and stated that "The 1966 amendments were designed, in part, specifically to mend this perceived defect in the former Rule."

A decision that the plaintiff can represent a class of 99,614 non-resident aliens would perpetuate the "one-way intervention" which the 1966 Amendment was designed to prevent.

If, after trial on the merits, plaintiff should obtain his requested judgment against defendants of $110,000,000 with interest, the 99,614 non-resident aliens would, if they became aware of this result, certainly seek payment of their losses. However, if judgment were rendered in defendants' favor, these non-resident aliens would not be bound.

Affidavits of leading counsel in principal European countries in which IOS stock was sold uniformly expressed the opinion that any adverse judgment in a United States class action would not be binding in their countries, and could be there litigated.

The affidavit of Ercole Graziadei, an "avvocato" in Rome and Milan, states that "under Italian law a non-

representative member of the plaintiff class in this action would not be bound by an adverse judgment of this Court, and that he would be able to sue the same defendants again on a similar cause of action in an Italian Court (assuming jurisdictional requirements are met) * * *'' (126A).

The affidavit of Charles Jolibois, an ''avocat'' in Paris, states (147A):

> ''7. If the members of the class are not required at the outset to 'opt in', *i.e.*, to sign and return a writing agreeing to be bound by any judgment in this action, it is my opinion that a French court would not recognize a judgment in favor of defendants in this action as a bar to a new action under Article 1382. It is a basic principle of French positive law that to renounce the right to go to justice, just as to enter into an engagement, there must be a positive act. A purely negative act, such as a failure to respond, does not suffice.''

John Godfray Le Quesne, a barrister of the Inner Temple of London, and one of ''Her Majesty's Counsel'' (161A-1), gave a comprehensive opinion in which he stated that, under English law, a judgment of a foreign court in favor of a defendant can bar a subsequent action in England only if the foreign court had jurisdiction, and that an IOS shareholder who received notice that he would be bound by a judgment unless he returned ''a signed statement removing himself from the class, and had neither returned such a statement nor taken any part in the action, would not be barred by the judgment in favour of the defendants from bringing a subsequent action in England against one of the defendants based on the same allegations of falsehood in the prospectus'' (161A-14).

If an English court would not recognize the District Court's class action judgment, it is unlikely that such a judgment would be recognized in Belgium, Denmark, Finland, Germany, Japan, Norway, Switzerland or any of the other foreign countries where IOS stock was sold, as binding on their nationals over whom the District Court has asserted jurisdiction through the notice (175A-176A).

Judge Frankel groped for a possible solution to this dilemma: He recognized that "if defendants prevail against a class, they are entitled to a victory no less broad than a defeat would have been", and suggested, "in the court's discretion, that putative members be required to 'opt in' or to face exclusion from the class for all purposes" (83A).

However, Rule 23 is limited to "opting out", and has no provision for opting in. Further, Avvocato Graziadei stated that in Italy, even if an Italian opted in and "in writing agreed to be bound by the judgment of this Court, a judgment of this Court adverse to the plaintiff class on the merits would not be accorded recognition in Italy and would not prevent the non-representative class member from maintaining a subsequent suit in an Italian court on the same cause of action against the same defendants" (126A).

In France, a different rule might apply to the IOS shareholder who opted in (147A).

Judge Frankel indicated that perhaps these numerous foreign countries might have short statutes of limitations, which might bar subsequent suit and thereby minimize the unfairness of such inherent one-way intervention. He stated that "It may, as has been suggested, become a moot question as supervening limitations periods render this in fact the only practical forum for asserted claims by foreign purchasers" (83A-84A).

However, it is submitted that a United States District Court either has or has not power to make non-resident aliens members of a class in its Court. Its power to do so cannot depend on a prior determination whether, in such alien's native land, there may be an applicable statute of limitations which might bar suit there,—especially in view of the many factors which might cause a statute to be tolled. It would make the morass even more impenetrable for a District Court, as a basis for asserting judicial jurisdiction over a non-resident alien, first to have to determine whether his claim had been barred by a statute of limitations de-

fense in his native country or would be barred before a judgment could be rendered in the United States.

Furthermore, the Jolibois affidavit indicates that a French action would lie under Article 1382 of the Civil Code, for which the applicable statute of limitations is thirty years (146A). While the nature of these unmanageable class actions is such that many years of litigation are inevitable,—as exemplified by *Eisen* v. *Carlisle & Jacquelin, supra,* where "Eight years have elapsed * * * [and] Both the parties and the courts are still wrestling with the complex questions surrounding petitioner's attempt to maintain his suit as a class action" (417 U.S. at 159),—hopefully this litigation can be completed before expiration of the French limitations period.

In short, there is no way out of the "one-way intervention" as to these 99,614 non-resident aliens other than a holding that they are not and cannot be made members of a class subject to the power and authority of the United States District Court.

POINT V

The Supreme Court lacked the power to prescribe Rule 23, as amended in 1966, since such rule is not limited to "practice and procedure", but abridges and modifies a "substantive right", contrary to 28 U.S.C. §2072.

A. This Court May Consider the Issue of Validity of Rule 23, Though Not Raised Below.

Defendant Andersen presents the issue of validity of Rule 23, as amended in 1966,—an issue not raised below. A court will consider issues not raised below where they "are of great significance" (*Green* v. *Brown,* 398 F.2d 1006, 1009 (2d Cir. 1968)) or where "there are significant questions of general impact" (*Krause* v. *Sacramento Inn,* 479 F.2d 988, 989 (9th Cir. 1973)). See also *Southard* v. *Southard,* 305 F.2d 730, 732 (2d Cir. 1962); *New York, N.H. &*

H.R. v. *Reconstruction Finance Corp.*, 180 F.2d 241, 244 (2d Cir. 1950). It is therefore appropriate for this Court to consider the validity of Rule 23,—clearly an issue of "great significance" and "of general impact".

No reported case has ruled on the validity issue, though District Court judges have expressed misgivings, indicating that Rule 23 constitutes a "radical extension [of] this Court's jurisdiction", is "unprecedented" and can cause a class member to forfeit a "previously unfettered right" (*School District of Philadelphia* v. *Harper & Row Publishers, Inc.*, 267 F.Supp. 1001, 1005 (E.D.Pa. 1967)). Cases such as *American Pipe & Construction Co.* v. *Utah*, 414 U.S. 538 (1974) and *Eisen* v. *Carlisle & Jacquelin, supra*, 417 U.S. 156 (1974) have ruled on aspects of Rule 23, without considering validity. Accordingly, neither such cases, nor the many decisions in the Courts of Appeal and District Courts which have struggled with the myriad aspects of Rule 23, can be deemed authority for sustaining its validity:

> "Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents" (*Webster* v. *Fall*, 266 U.S. 507, 511 (1925)).

B. The Supreme Court's Power to Prescribe Rules Is Limited to "Practice and Procedure" and Such Rules May Not Abridge or Modify a "Substantive Right."

The Supreme Court's power to prescribe rules is governed by 28 U.S.C. §2072,* known as the "Rules Enabling

* "§2072. Rules of civil procedure

"The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of ap-

(footnote continued on next page)

Act." The Supreme Court's rule-making power is limited to rules governing "forms of process, writs, pleadings, and motions, and the practice and procedure" of the federal courts. There is a strong *caveat* that "Such rules shall not abridge, enlarge or modify any substantive right."

The issue under 28 U.S.C. §2072 thus comes down to whether a change in the Rule from one in which a person may not be bound by a judgment unless he becomes an actual party to the suit, to one in which, by mere notice and failure to opt out, he becomes bound by a judgment, whether favorable or adverse, because represented by a person he did not select, and of whom he may never have heard, and perhaps even without knowing that he was a member of a class,* is merely a matter of "practice and procedure" or in fact abridges or modifies a "substantive right" and extends the jurisdiction of the District Court. This, in turn, requires exploration of the intended coverage of the phrase "practice and procedure" of the federal courts.

C. The Meaning and Scope of the Phrase the "Practice and Procedure" of the Federal Courts.

The Rules Enabling Act was first enacted on June 19, 1934, c. 645, 48 Stat. 1064. The House Report stated that its purpose was to "promote simplicity and uniformity of practice in all Federal courts" (H. Rep. 1829, 73d Cong., 2d Sess. (May 30, 1934)).

In *Sibbach* v. *Wilson & Co.*, 312 U.S. 1, 10 (1941), the Court stated that the Rules Enabling Act "was purposely

peals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

"Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution * * *."

* As stated in *Alameda Oil Company* v. *Ideal Basic Industries, Inc.*, 326 F. Supp. 98, 103 (D.Col. 1971), class members will be bound by a judgment in a Rule 23 action "even though they may not be actually aware of the proceedings."

restricted in its operation to matters of pleading and court practice and procedure", and that *caveats* in the Act "emphasize this restriction".

The Supreme Court has often recognized that it is restricted in its rule-making powers, and has invalidated its own rules where they have exceeded the scope of its authority under the Rules Enabling Act. *Hanna* v. *Plumer*, 380 U.S. 460, 471 (1965); *Sibbach* v. *Wilson & Co., supra*, 312 U.S. 1, 10 (1941); *Meek* v. *Centre County Banking Co.*, 268 U.S. 426 (1925); *Davidson Marble Co.* v. *Gibson*, 213 U.S. 10, 19 (1909); *J. B. Orcutt Company* v. *Green*, 204 U.S. 96, 102 (1907); *Hudson* v. *Parker*, 156 U.S. 277, 284 (1895).

Realistically, as Mr. Justice Douglas stated in his dissent to the proposed Rules of Evidence, the Supreme Court does not really prescribe the rules,—it is done by the Advisory Committee, and the Supreme Court is a mere conduit.*

Mr. Justice Douglas, in his dissent, expressed doubt whether rules of evidence are within the purview of the Rules Enabling Act:

> "The words 'practice and procedure' in the setting of the Act seem to me to exclude rules of evidence. They seem to me to be words of art that describe pretrial procedures, pleadings, and procedures for preserving objections and taking appeals" (56 F.R.D. 185).

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* "Second, this Court does not write the Rules, nor supervise their writing, nor appraise them on their merits, weighing the pros and cons. The Court concededly is a mere conduit. Those who write the Rules are members of a Committee named by the Judicial Conference. The members are eminent; but they are the sole judges of the merits of the proposed Rules, our approval being merely perfunctory. In other words, we are merely the conduit to Congress. Yet the public assumes that our imprimatur is on the Rules, as of course it is" (56 F.R.D. 185).

Mr. Justice Black also stated, with respect to the 1966 amendments, that the advisory "committees, not the Court, wrote the rules * * * [T]he Court's transmittal does not carry with it a decision that the amended rules are all constitutional" (383 U.S. 1032 (1966)).

Then Chief Judge Friendly,—making it clear that he spoke only for himself and not for the other members of this Court,—referred to Mr. Justice Douglas' views as to whether the proposed Rules of Evidence were within the Enabling Act, and stated that "I share the doubts Mr. Justice Douglas has voiced on that subject".*

Former Mr. Justice Arthur J. Goldberg, referring to the legislative history of the initial Rules Enabling Act, stated: "As I read the legislative record [as to the Rules Enabling Act], this was only designed for housekeeping rules", whereas the proposed Rules of Evidence dealt with "substantive rules", as to which "Congress should initiate and enact affirmative legislation" (Hearings, Feb. 8, 1973, at p. 142).

Congress itself deemed the proposed Rules of Evidence as not included within the "practice and procedure" authorization of the Rules Enabling Act. Accordingly, by Public Law 93-12, approved March 30, 1973, it provided that the Rules of Evidence "shall have no force or effect except to the extent, and with such amendments, as they may be expressly approved by Act of Congress" (87 Stat. 9). And to highlight that the Supreme Court, in prescribing the Rules of Evidence, had assumed a legislative function, the Act is entitled one "To promote the separation of constitutional powers".

The House debate on the proposed Rules of Evidence indicated that many legislators deemed the Supreme Court's authority to promulgate rules as limited to "technical procedural matters" and "housekeeping court procedures",** whereas rules of evidence are "substantive".

With this clarification of the scope of the term "practice and procedure", there may be considered whether the

* Hearings before the Special Subcommittee as to Rules of Evidence, Feb. 22, 1973, 93d Cong., 1st Sess., Serial No. 2, p. 246 (the "Hearings"); Statement of Henry J. Friendly, Chief Judge (*Id.* at 261, repeated also at p. 246).

** Cong. Rec. March 14, 1973, Vol. 119, No. 40, at H 1722, H 1723 and H 1727.

change made in Rule 23 by the 1966 Amendments is a mere matter of "practice and procedure" or does, in fact, abridge or affect a substantive right.

D. The "Unprecedented" Change Made by the 1966 Amendment to Rule 23 and Its "Radical Extension" of the District Court's Power to Bind to a Judgment Members of a Class Not Before It.

Old Rule 23(a)(3),—which covered the "spurious" class action,—was "merely a permissive joinder device in which the right and liability of each individual plaintiff is distinct and no member of the 'class' is bound by a judgment who does not join as plaintiff or intervenor" (*Schatte* v. *International Alliance,* 183 F.2d 685, 687 (9th Cir.), *cert. denied,* 340 U.S. 827 (1950)).

Oppenheimer v. *F. J. Young & Co.,* 144 F.2d 387, 390 (2d Cir. 1944),

> "adverted to the settled rule in the Second Circuit that members of the class who are not joined in such a class suit will not be affected by the decision. In other words, *the decision will only be res judicata as to the plaintiffs and parties who have intervened.*"

Accordingly, the only persons who could be bound by a judgment under former Rule 23(a)(3) are those who become actual parties, either through voluntary intervention or by service of process in accordance with normal "due process" requirements for a lawsuit,—requirements governed by *International Shoe Co.* v. *Washington,* 326 U.S. 310 (1945) and *Hanson* v. *Denckla,* 357 U.S. 235 (1958).

The 1966 Amendments made a basic and radical change in the substantive law, modified a major "substantive right" and extended the District Court's jurisdiction to bind to a judgment persons over whom it previously had no such power because not before the Court.

Moore summarizes the distinction between the old Rule and the new Rule as follows:

> "The most significant difference between the new (b)(3) class suit and the former 'spurious' class action is the *expansion of the reach of the judgment,* which now binds all members of the class who do not exclude themselves; previously, only those members who intervened in the action were bound by its result" (3B J. MOORE, *Federal Practice,* ¶23.45[1] at 23-701-2 (2d Ed. 1974) (footnote omitted)).

American Pipe & Construction Co. v. *Utah, supra,* explains that under the former Rule, "putative members of the class who chose not to intervene or join as parties would not be bound by the judgment" (414 U.S. at 547), whereas under the new Rule, a member of the class to whom a notice is mailed and who does not opt out "must abide by the final judgment whether favorable or adverse" (414 U.S. at 549).

E. Issues as to Binding Persons to a Judgment, *Res Judicata,* Collateral Estoppel and Estoppel by Judgment Are Matters of Substantive Law, and a Rule With Respect to Such Matters Affects a "Substantive Right."

A plaintiff's purpose in suing is to obtain a judgment and a defendant's objective is to defeat a judgment. Rules of evidence are merely steps used to obtain or defeat the judgment and, in such sense, become substantive in nature, but not to the same extent as the judgment itself. It must be for this reason that Congress deemed the rules of evidence not to be included in the phrase "practice and procedure", but to be of a substantive nature outside the Supreme Court's rule-making power. Otherwise, rules of evidence are normally deemed part of procedure,* if that

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* Wigmore states that "the law of Evidence is a part of the law of Procedure" (1 J. H. Wigmore, *Evidence,* §5 at 159 (3d Ed. 1940)).

Professor Moore, in his recent article on "Congress, Evidence and Rulemaking" (co-authored with Bendix), states:

> "Rules of evidence are clearly within the Supreme Court's rulemaking power. They are procedural, for they govern the presentation of facts to court or jury, enabling the trier to apply relevant principles of substantive law on the basis of the facts adduced" (84 Yale L.J. 9, 11-12 (Nov. 1974)).

term is given a broad interpretation, rather than the restrictive one applied to it by both Mr. Justice Douglas in his dissenting opinion, and by Congress.

If, therefore, rules of evidence are deemed substantive, and therefore beyond the Supreme Court's power to prescribe, *a fortiori* would issues of the binding effect of a judgment and *res judicata* be substantive and outside the Supreme Court's rule-making authority.

In *California Apparel Creators* v. *Wieder of California,* 162 F.2d 893, 896-7 (2d Cir.), *cert. denied,* 332 U.S. 816 (1947), Judge Clark, after describing a Rule 23(a)(3) class action as "merely a device of permissive joinder * * * [which] does not grant authority to adjudicate finally rights as to nonappearing parties," held that inasmuch as potential class members were not before the court, *"we cannot give judgment as though they were", since the court cannot "confer any additional substantive rights upon the plaintiffs suing",*—clear recognition that to bind to a judgment parties not before the court, as alleged members of a class, affects "substantive rights".

Numerous cases establish that the issue as to the binding effect of a judgment, *res judicata,* estoppel by judgment or collateral estoppel, are also matters of substantive law. The issue most frequently arises in diversity cases since under *Erie R. Co.* v. *Tompkins,* 304 U.S. 64 (1938), matters of substantive right, unlike matters of "practice and procedure", must be determined by the law of the forum state.

In *Priest* v. *American Smelting & Refining Co.,* 409 F.2d 1229, 1231 (9th Cir. 1969), the Court stated:

> "Since federal jurisdiction in this case is based upon diversity of citizenship, the district court and this court must apply the substantive law of the forum state, the State of Washington. See 28 U.S.C. §1652 (1964); Erie R. Co. v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188; Davis v. Aetna Life Insurance Co., 9 Cir., 279 F.2d 304, 307. *The substantive law of a*

> *state includes the law pertaining to res judicata.* Gramm v. Lincoln, 9 Cir., 257 F.2d 250, 255 n. 6. It must therefore, we believe, also include the law pertaining to collateral estoppel. See Centennial Insurance Company v. Miller, E.D.Cal., 264 F.Supp. 431, 433."

Ritchie v. *Landau,* 475 F.2d 151, 154 (2d Cir. 1973), states:

> "In a diversity action in federal court the state law is controlling on the question of the applicability of the collateral estoppel doctrine to a given set of circumstances."

Lynne Carol Fashions, Inc. v. *Cranston Print Works Co.,* 453 F.2d 1177, 1179 (3d Cir. 1972), held that *Erie* requires a federal court to "apply the substantive law of the state in which it sits" and that the issue of collateral estoppel "is one of substance as distinguished from one of procedure."

Breeland v. *Security Insurance Co. of New Haven, Conn.,* 421 F.2d 918, 921 (5th Cir. 1969), holds that "Because this is a diversity case, the law of the state where the District Court sat controls questions of res judicata and estoppel."

Furthermore, Rule 23, in its extension of the Court's power to bind persons to a judgment, requires some method of identifying the persons bound. The method selected, of course, is notice to members of the class, either mailed to their last known address or published somewhere.

Since the members of the class are those who do not opt out, the effect is that when the court renders a judgment binding on all members of the class, it has succeeded only in identifying those persons not bound by the judgment; the persons bound by the judgment may still be unknown. But, as stated in *Chicago, Rock Island & Pacific R.R. Co.* v. *Schendel,* 270 U.S. 611, 620 (1926), "Identity of parties is not a mere matter of form, but of substance."

Binding unknown and unidentified persons to a judgment is not a novel concept in the law, and is often necessary, as in the case of unknown heirs. However, "Jurisdiction to sue such persons must be obtained in pursuance of some statute, since otherwise there is no authority to proceed against them as unknown persons, * * *. And where such a *statute providing a constitutional method of procedure* has been followed, the unknown persons are bound by the judgment to the same extent as if they had been named." (I Freeman, *Judgments,* §416 at 906 (5th ed.)).

Presumably, Congress could enact a statute "providing a constitutional method of procedure" which would enable binding parties who may be unknown and unidentified when the judgment is entered. But clearly, this cannot be accomplished through a court rule, in view of the restrictive nature of the Rules Enabling Act.

This basic principle, inherent in our jurisprudence, that an unknown and unidentified person can be bound by a judgment in an action only by "statute providing a constitutional method" has not been changed by any known decision of the Supreme Court, and cannot be changed by a rule of procedure adopted by the Supreme Court.

In *Davidson Marble Co.* v. *Gibson, supra,* 213 U.S. 10, 19 (1909), a rule of Court provided that any special appearance had to include a provision that if the special appearance was denied, the same document constituted a general appearance, which had the effect of subjecting the party to the jurisdiction of the Court and binding him to a judgment. This rule was held invalid because "the jurisdiction of the Circuit Courts is fixed by statute", and "it was beyond the power of the Circuit Court to make and enforce a rule which * * * transforms an objection to the jurisdiction into a waiver of the objection itself."

Meek v. *Centre County Banking Co., supra,* 268 U.S. 426 (1925), exemplifies the extent to which the Supreme Court will invalidate even its own order, when it appears in

an adversary proceeding to have affected a "substantive" right. That case involved General Order in Bankruptcy No. 8, promulgated by the Supreme Court under its rule-making power granted by Congress under Section 30 of the Bankruptcy Act. 11 U.S.C. §53. The General Order authorized any member of a partnership, without the consent of his other partners, to seek a bankrupty adjudication for the partnership. Such order did not mean that the partnership would in fact be adjudicated a bankrupt, since the non-consenting partners could resist the adjudication, and the determination would then be made on the merits and everyone had the opportunity for his day in court before judgment.

Nevertheless, the Supreme Court, finding no express authority in the Bankruptcy Act for a voluntary partnership petition when one partner objected, deemed its own order as going beyond matters of rule, form and procedure, and as affecting a "substantive" right, which the Court was not empowered to do. Accordingly, the Supreme Court invalidated its own order.

The forced general appearance in *Davidson Marble Co.* v. *Gibson, supra,* and the adjudication in bankruptcy in *Meek* v. *Centre County Banking Co., supra,*—involving parties actually before the Court, with full knowledge of the Court proceedings,—is far less drastic than rendering judgment affecting 100,000 persons not before the Court, and who may never even have heard of the case in which they are held to be members of a global class. There could hardly be a clearer case of a rule which affects a "substantive right".

F. Until 1966, the Advisory Committee Consistently Refused to Sanction a Rule Whereby a Judgment Could Be Binding on a Class Member Who Did Not Become an Actual Party Through Joinder or Intervention, Because It Deemed That Such a Rule Was Not a Matter of "Practice and Procedure" but Would Modify a "Substantive Right."

The keynote for the Federal Rules of Civil Procedure prescribed in 1938, as a result of the Rules Enabling Act, passed June 19, 1934 (48 Stat. 1064), was sounded by Chief Justice Hughes before the American Bar Association, in which he stated that the Rules would be prepared on the basis of no "violation of any substantive right" (21 ABAJ 340, 342 (June 1935)). Until 1966, the Advisory Committee was always guided by this *caveat*.

Rule 23(a), as prescribed in 1938, was extremely brief. It covered the three classic types of class action, the so-called "true" class, covered by subdivision (1); the "hybrid" class, covered by subdivision (2); and the "spurious class", covered by subdivision (3).*

Professor James W. Moore proposed a provision, but limited to subdivision (1), to the effect that members of a "true" class should be bound by a judgment. He explained

* Former Rule 23(a) reads as follows:

"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

(1) joint, or common, or secondary in the sense that the owner of a primary right refuses to enforce that right and a member of the class thereby becomes entitled to enforce it;

(2) several, and the object of the action is the adjudication of claims which do or may affect specific property involved in the action; or

(3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought."

his position in a law journal article,* in which he stated that "The law on class actions is inextricably bound up with jurisdiction, and the binding effect of the judgment * * *." Accordingly, his limited proposal as to the binding effect of the judgment, relating only to subdivision (1), covering "true" class actions, was as follows:

> "(b) *Effect of Judgment. The judgment rendered in the first situation is conclusive upon the class;* in the second situation it is conclusive upon all parties and privies to the proceeding, and upon all claims, whether presented in the proceeding or not, insofar as they do or may affect specific property involved in the proceeding; and in the third situation it is conclusive upon only the parties and privies to the proceeding."

The Advisory Committee rejected this provision, simply stating:

> "The Committee consider it beyond their functions to deal with the question of the effect of judgments on persons who are not parties" (Report of the Advisory Committee on Rules for Civil Procedure, Notes on Rule 23 at 60 (Apr. 1, 1937)).

Professor Moore stated the reason his proposal was rejected:

> "This was due to the feeling that such a matter was one of substance and not one of procedure" (*Federal Class Actions—Jurisdiction and Effect of Judgment,* Moore & Cohn, 32 Ill. Law Rev. 555, 556 (1938)). See also 46 Col. L. Rev. 818, 824 (1946).

The original Rules of Civil Procedure adopted in 1938 provided in Rule 14(a), as to third-party practice, that:

> "The third-party defendant is bound by the adjudication of the third-party plaintiff's liability to the plaintiff, as well as of his own to the plaintiff or to the third-party plaintiff."

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* Moore and Cohn, "Federal Rules of Civil Procedure: Some Problems Raised by the Preliminary Draft," 25 Geo. L.J., 551, 571 (1937).

In the 1948 Amendments, the Advisory Committee deleted this sentence from Rule 14(a), and explained that it did so "because the sentence *states a rule of substantive law* which is not within the scope of a procedural rule. *It is not the purpose of the Rules to state the effect of a judgment*" (Advisory Committee Note, 5 F.R.D. 433, 448 (1946)).

In 1955 the Advisory Committee proposed to amend Rule 23 to include a possibility that absent persons might be bound by a judgment, but the proposal was rejected. The Advisory Committee apologized that "The amended rule does not undertake to regulate the effect of res judicata upon the judgment in a class action". (See 12 Wright & Miller, *Federal Practice and Procedure* at 596.)

In 1964, the Advisory Committee first proposed to modify the provisions as to the "spurious" class action to bind class members who had not intervened, but received a mere notice. It was proposed to amend Rule 23(b)(3) to expand the spurious class action, and to amend Rule 23(c)(2) to provide as follows (34 F.R.D. 325, 386):

> "The judgment in an action maintained as a class action shall extend by its terms to the members of the class, as defined, whether or not the judgment is favorable to them".

The Advisory Committee notation on these proposed amendments, in bold face type, made the following statement (34 F.R.D. 395):

> **"Special Note To Bench And Bar: The Advisory Committee recognizes that the proposal embodied in subdivision (b)(3) and the related subdivision (c)(2) is novel. Accordingly, the Committee will particularly welcome comments on this proposal."**

The Advisory Committee could hardly have made clearer the unprecedented nature of its proposal to bind to a judgment persons who were not parties actually before the Court, but merely made part of a class by court rule.

However, the substance of the proposed 1964 Amendments, namely, the binding to a judgment parties not before the Court, except as members of a class, was included in the final Rules as adopted in 1966.

The then Advisory Committee totally disregarded the view of the original Advisory Committee that to deal with the question of the effect of judgments on persons who are not parties is, as Moore stated, a matter "of substance and not one of procedure". Though the law is so clear that the issue of a judgment and *res judicata* is a substantive matter, and the Advisory Committee had consistently rejected any suggestion of including such matters in its Rules, in 1966, it made such unprecedented, radical and sweeping changes, without any comment or discussion of this very significant aspect, or any consideration whether the proposed change modified any substantive right, contrary to 28 U.S.C. §2072, or extended the District Court's jurisdiction, contrary to Rule 82. All the Advisory Committee said is that "on a realistic view, it would seem fitting for the judgments to extend to the class" (39 F.R.D. at 99). Perhaps, as Judge Friendly stated with respect to the proposed Rules of Evidence, the error lay in "too ready acceptance, without opportunity for any full debate" (Hearings, p. 88, *supra,* at 246).

By calling absent, unknown and unidentified persons "members of the class" whose interests are "fairly and adequately" protected by the class representative, the Advisory Committee used what Judge Clark has fittingly described as "the process of hypostasis of these nameless and as yet disembodied spirits." (*All American Airways* v. *Eldred,* 209 F.2d 247, 249 (2d Cir. 1954)).

In short, Rule 23 modified "substantive rights", "in the guise of regulating procedure", contrary to the interdiction of *Sibbach* v. *Wilson & Co., supra,* 312 U.S. 1, 10 (1941).

POINT VI

Rule 23 is invalid in empowering a Federal Court to acquire jurisdiction over persons anywhere in the world, merely by mailing them a notice and binding them to a judgment, if they do not opt out.

Rule 23 also extends the jurisdiction of United States District Courts in violation of Rule 82.

The reach of Rule 23 is extensive. It covers both plaintiff and defendant classes. It grants the District Court power and jurisdiction over all members of both types of classes. It applies in diversity actions and in actions arising under laws of the United States. A mere "notice" is all that is needed to bind to a judgment hundreds, thousands, or even millions of unidentified persons all over the United States, and perhaps all over the world.

In the traditional non-class action, where one or more persons sue one or more defendants, basic concepts of due process of Constitutional dimension are applicable. These include the "traditional notions of fair play and substantial justice", of *Milliken* v. *Meyer*, 311 U.S. 457, 463 (1940); the "certain minimum contacts" with "the territory of the forum", of *International Shoe Co.* v. *Washington*, 326 U.S. 310, 316 (1945); and acts "invoking the benefits and protections" of the laws of the forum state, of *Hanson* v. *Denckla*, 357 U.S. 235, 253 (1958). That these concepts retain viability was made clear in *Leasco Data Processing Equipment Company* v. *Maxwell*, 468 F.2d 1326, 1340 (2d Cir. 1972), in reaffirming "the modern notions" that where a person "has acted within a state or sufficiently caused consequences there, he may fairly be subjected to its judicial jurisdiction even though he cannot be served with process in the state".

The foregoing cases evidence the most modern "due process" requirements before a court can exercise judicial jurisdiction over a party outside the forum.

In *Eisen III*, 479 F.2d at 1015, this Court, in referring to the requirement of "individual notice to these [class]

members", stated that "this phase of amended Rule 23 has decided constitutional overtones." In recognition of this, as already noted (p. 27, *supra*), the Advisory Committee Notes on Rule 23 stressed the need for a notice "designed to fulfill requirements of due process to which the class action procedure is of course subject" (39 F.R.D. at 107).

A. The "Notice" Requirement of "Due Process" in a Class Action

The ultimate objectives of "notice" in a class action and "process" in ordinary litigation are identical,—to subject a person to the jurisdiction and power of the federal court, so that such court can affect his substantive rights and bind him to a judgment. Accordingly, the constitutional aspect of due process is not basically different in an individual action from a class action, in which, as stated in *Hansberry* v. *Lee, supra,* 311 U.S. at 42, "the requirements of due process and of full faith and credit" must also be satisfied. If anything, the procedure "designed to fulfill requirements of due process" should be more rigid in a class action, where there may be hundreds of thousands of litigants whose rights are determined in a dragnet situation.

Judge Frankel early articulated the hazards:

> "The courts are not free, as they were before July 1, to treat the class action allegation as merely a permissive invitation to joinder. The authorization of a class suit has a grave significance now. It portends binding judgments for scores or hundreds of people who are not before the court in the usual way. I would suspect that the courts will not be insensitive to such potentially sweeping consequences."*

Judge Lumbard's dissent in *Eisen* v. *Carlisle & Jacquelin,* 391 F. 2d 555, 570 (2d Cir. 1968) observed that in class actions with a large number of "potential plaintiffs living in every state of the union and in almost every for-

* Frankel, "Amended Rule 23 From a Judge's Point of View", 32 ABA Antitrust L. J. 295, 297 (1966).

eign country * * * a substantial proportion of its membership will have no idea whatever that they belong to it.''*

Hansberry v. *Lee* was cited in the Advisory Committee Notes to show that the notice to class members prescribed by Rule 23(c)(3) ''fulfill(s) the requirement of due process.''

Hansberry is here relevant only for the general proposition that it is possible, consistent with due process, to have a class action in which members of the class who are parties ''may bind members of the class or those represented who were not made parties to it'' (p. 41). But *Hansberry* prescribes basic principles governing due process which, it is submitted, do not bear the remotest relationship to the ''notice'' requirement of Rule 23(c)(2).

First, *Hansberry* v. *Lee* reaffirmed the ''principle of general application in Anglo-American jurisprudence that one is not bound by a judgment *in personam* in a litigation in which he is not designated as a party or to which he has not been made a party by service of process'' (p. 40).

Second, *Hansberry* states that ''due process'' requires a procedure which ''fairly insures the protection of the interests of absent parties who are to be bound by it'' (p. 42).

Third, *Hansberry* states that if ''the members of the class who are present are, by generally recognized rules of law, entitled to stand in judgment for those who are not'', then it will ''assume for present purposes that such procedure affords a protection to the parties who are represented, though absent, which would satisfy the requirements of due process and full faith and credit'' (p. 43).

Hansberry also cautioned against opportunities for ''collusive sacrifice of the rights of absent parties'' (p. 45).

* Illustrative is the response to the class action notice referred to above (p. 29, fn.): ''Dear Mr. Clerk. I would like to know why I am a party to this action that I don't know nothing about. Who made me a party to anything?''

Having stated such principles applicable to due process, *Hansberry* concluded that "the procedure and the course of litigation sustained here by the plea of *res judicata* do not satisfy these requirements" (p. 44).

Eisen v. *Carlisle & Jacquelin, supra,* 417 U.S. 156, 176 (1974), stressed that the Rule 23 notice is "an unambiguous requirement * * * intended to insure that the judgment, whether favorable or not, would bind all class members who did not request exclusion from the suit". Despite such effect of a Rule 23 notice in binding all class members to a judgment, the Rule does not even purport to comply with the standards for class representation prescribed by *Hansberry.* It sets no standard as to whether "the representative parties will fairly and adequately protect the interests of the class" (23(a)(4)),—the key to "due process", in addition to the notice requirement. The Rule as to what is needed to be a representative party is vague, undefined, and so lacking in criteria as to violate the due process and equal protection guarantees of the Constitution.

And Mr. Justice Black, appalled at the absence of "carefully prescribed legal standards enacted to control class suits" in the 1966 Amendments, stated:

> "It seems to me that they place too much power in the hands of the trial judges and that the rules might almost as well simply provide that 'class suits can be maintained either for or against particular groups whenever in the discretion of a judge he thinks it is wise' " (383 U.S. at 1035 (1966)).

State legislatures have traditionally prescribed requirements for service of process in individual suits, consistent with current conceptions of due process. Rule 4, as to service on a party not an inhabitant of or found within the state in which the District Court is held, authorizes service in the manner prescribed in the state. Certain specific federal statutes also authorize nationwide jurisdiction.

The requirements for service of process, as set forth in Rule 4, contain nine separate subdivisions, many with fur-

ther subdivisions, and Rule 4 occupies four large printed pages, all designed to satisfy due process requirements.

Rule 23(c)(2), the "due process" counterpart of Rule 4, which also seeks to bind parties to a judgment, merely devotes a few lines to method of service:

> "[T]he court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort."

This provision falls far short of satisfying the requirements of *Hansberry* v. *Lee*, as to "process" for class members.

The present case,—which experience shows is typical of so many class actions,—demonstrates the inadequacy of the Rule 23 notice requirement, by illustrating the inadequacy of the notice here proposed and approved by Judge Carter (287A).

The Drexel offering amounted to $56,000,000; the IOB offering, to $39,500,000; and the Crang offering, to $14,500,000. As already noted, the purchasers total approximately 100,000, 99,614 of whom are non-resident aliens, and 374 are non-resident American citizens. Such non-residents are scattered in a large number of countries in Europe, Asia, Africa, Australia and South America. The record does not contain a breakdown of the number of separate persons who purchased under the Drexel offering or where they are located, other than the prospectus, which shows that sales under this offering were made in Europe, Japan and Australia (175A).

Although Judge Frankel allegedly made a class determination on June 28, 1972, no notice was sent to class members or even prepared for sending, until the notice as to the proposed partial settlement, approved by Judge Carter on December 4, 1974, which is a combined class action notice under Rule 23(c)(2) and a settlement notice under Rule 23(e).

Judge Carter's order directs the notice to be sent only to those who purchased under the Drexel offering, "at the

last known address'' in the records of the Drexel Group, which in most cases would be 1969 addresses (285A).

The Drexel Group must simply request Crang and IOB to mail the notice to purchasers under those two offerings (285A), which represent $54,000,000, but there is no compulsion on their part to comply with such request. Hence, the mailed notice may in fact be received only by those who bought under the Drexel offering, and not those who bought under the Crang and IOB offerings.

When the underwriters sold IOS stock, because of the foreign nature of the offerings, the prospectuses were printed in five foreign languages. The proposed notice of class determination and settlement, advising class members that they will be bound by a judgment unless they opt out, is in English only. The recommendations made in the District Court that the notices also be printed in French and German were rejected.

Though the offerings were made in six continents, publication is limited to The New York Times, the Montreal Gazette, the Globe and Mail of Toronto, and the International Herald Tribune in Paris (285A), on the assumption that this is sufficient notice to buyers in Japan, Norway, Denmark, Germany, Australia, Africa, South America, and in the many other foreign countries in which the sales were made. In *Eisen III,* 479 F.2d at 1017, this Court stated that ''no notice by publication could be devised by the ingenuity of man that could reasonably be expected to notify more than a relatively small proportion'' of a diverse and dispersed class membership, and therefore that ''a ruling should have been made forthwith dismissing the case as a class action''.

As stated in *Mullane* v. *Central Hanover Trust Co., supra,* 339 U.S. 306, 315 (1950), ''when notice is a person's due, process which is a mere gesture is not due process''. The vagueness of the Rule 23(c)(2) standard for notice is such that any notice there sent, of which the ''notice'' in this case may be deemed typical, ''is a mere gesture and is not due process''.

B. The "Adequate Representation" Requirement of "Due Process" in a Class Action

Hansberry v. *Lee, supra,* 311 U.S. at 42-3, establishes that basic to due process in a class action is "adequate representation". As the Court there stated:

> "It is *familiar doctrine* of the federal courts that members of a class not present as parties to the litigation may be bound by the judgment where they are in fact *adequately represented* by parties who are present * * *."

The Advisory Committee Notes elide this basic consideration by simply stating that the Rule sets forth "the desired qualifications of the representative parties". The Rule, however, merely states that "(4) the representative parties will fairly and adequately protect the interests of the class".

The Advisory Committee Notes, referring to the situation before the proposed 1966 Amendments, define the "'true' category" of class actions as "involving 'joint, common, or secondary rights' ", and "the 'hybrid' category, as involving 'several' rights related to 'specific property' "; and state that "the judgments in 'true' and 'hybrid' class actions would extend to the class" (39 F.R.D. 98). It also states that "the judgment in a 'spurious' class action would extend only to the parties, including intervenors" (39 F.R.D. 98).

Such language of *Hansberry* as to being "adequately represented" was written in 1940, 26 years before the 1966 Amendments. The "familiar doctrine" to which it referred must therefore be read in terms of the type of class actions in which an absent party could then be bound by a judgment, if "adequately represented", namely, the "true" and "hybrid" class actions.

Accordingly, the above-quoted statement in *Hansberry* v. *Lee* as to "familiar doctrine" that a party may be bound by a judgment if "adequately represented" did not and could not refer to a class action of the type authorized by former Rule 23(a)(3),—the "spurious" class action in

which the only parties who could be bound by a judgment were those who intervened; and in which an absent party could not be bound, whether or not "adequately represented".

Moore noted the importance, prior to 1966, of

> "the type of class action involved—whether true, hybrid, or spurious. The reason this factor was important was that the res judicata effect of the judgment was not the same in all three types of class actions; and *this had a bearing on what constituted adequate representation.*"
>
> * * *
>
> "The question of adequate representation was very important in the true class suit under the original rule, for there a judgment on the merits bound all the members of the class and *adequate representation was essential to due process of law*" (3B J. Moore, *Federal Practice*, ¶23.07 [1] at 23-353 (2d ed. 1974)).

In all the cases which gave rise to such "familiar doctrine", there was always a real, *bona fide* plaintiff, who had an actual personal stake in the action and a personal interest in its outcome,—rather than merely a nominal plaintiff used by a lawyer to bring a class action to create a substantial legal fee.

Thus, the classic case of *Supreme Tribe of Ben-Hur* v. *Cauble*, 255 U.S. 356 (1921), involved a fraternal benefit association which had issued policies to its members containing certain benefits adversely affected by a reorganization which created a new class of benefit certificate holders. Existing benefit certificate holders instituted suit to determine the validity and binding effect of the reorganization. The parties to the action were thus true parties, having a personal stake, and all the old benefit certificate holders " 'had a common but indivisible interest.' " Therefore it " 'was strictly a true class suit, presenting questions of common interest to all the members of Class A and affecting their joint interests in funds and in internal management of the society' " (p. 361).

In *Hansberry* v. *Lee, supra,* 311 U.S. 32, 44 (1940), the class consisted of persons who had signed restrictive agreements, preventing sale of property to a certain racial group,—a provision which directly affected the property interests of plaintiffs, who brought the suit, and others whom they sought to bind by the judgment as *res judicata.* The Court stated:

> "The restrictive agreement did not purport to create a joint obligation or liability. * * * It is plain that in such circumstances all those alleged to be bound by the agreement would not constitute a single class in any litigation brought to enforce it."

Mullane v. *Central Hanover Bank & Trust Co., supra,* 339 U.S. 306 (1950), involved a judicial accounting by a bank for a common fund, in which plaintiff, as did all the class members, had a real interest.

Thus, all decisions before the 1966 Amendments,—such as *Supreme Tribe of Ben-Hur, Hansberry* and *Mullane,* and the many forerunners of those cases which led to the formulation of the "familiar doctrine" referred to in *Hansberry,* were all cases of a *bona fide* plaintiff, with a personal stake in the case, and a financial interest in vindicating his position, and, concomitantly, the position of the class, so that he could "adequately represent" the class. This, together with adequate "notice" are the ingredients of "due process" under *Hansberry.*

In *Snyder* v. *Harris,* 394 U.S. 332, 338 (1969), the Court, referring to its consistent interpretation of a jurisdictional statute, stated that "The interpretation of that statute cannot be changed by a change in the Rules". *A fortiori* an interpretation by the Court of the Constitutional requirement of due process "can not be changed by a change in the Rules".

The situation, of course, is vastly different with respect to the new "spurious" class action, as broadened in 1966, to expand "the reach of the judgment" (3B J. Moore, *supra,* p. 27), and to bind to a judgment alleged members of a class who, before such Amendments, could not be bound.

In the new class action created by Rule 23(b)(3), the requirement of having a representative party who "will fairly and adequately protect the interests of the class" is generally not met and will not be met.

As Judge Weinfeld stated in *Free World Foreign Cars, Inc.* v. *Alfa Romeo, supra,* 55 F.R.D. 26, 30 (S.D.N.Y. 1972), Rule 23(b)(3) class actions may have "resulted in miniscule recoveries by its intended beneficiaries, while lawyers have reaped a golden harvest of fees".

In *Eisen* v. *Carlisle & Jacquelin, supra,* 417 U.S. 156 (1974), after eight years without trial on the merits, the Court noted that "A critical fact in this litigation is that petitioner's individual stake in the damage award he seeks is only $70" (p. 161), whereas "individual notice to all identifiable class members would cost $225,000, and additional expense would be incurred for suitable publication notice" (p. 167).

The case at bar, though not quite as extreme, is comparable, since plaintiff's stake is $6,000, as compared with the $50,000 cost of notice to the 100,000 class members.

The reality of the "adequate representation" aspect of "due process", as applied to the new "spurious" class action created in 1966, was bared in *La Mar* v. *H&B Novelty & Loan Co.,* 489 F.2d 461, 465-6 (9th Cir., 1973), as follows:

> "The difficulty with this position is that compliance with the prerequisite must necessarily be determined more by examination of the fitness of the counsel of the candidate for representative party status than by the attributes of the candidate. Once the ability of counsel becomes the measure by which compliance with the fourth prerequisite is determined, there remains only a formal and technical reason for insisting that there be a representative party at all."

Judge Weinfeld also recognized this aspect in *Free World Foreign Cars, Inc.* v. *Alfa Romeo, supra,* and stated that Rule 23(a)(4) "is not restricted to the adequacy of

legal representation, but also requires that the purported representative have common interests with its members and that there be no existing or potential conflict of interest'' (p. 29). This, it may be assumed, means that, to be an adequate representative, plaintiff's objective must be solely to maximize recovery for himself and the class members, and not merely to aid and abet a substantial fee to his counsel.

Judge Friendly, in considering the consequences of ''the judicial gloss'' placed on Rule 23(b)(3), stated:

> ''While the benefits to the individual class members are usually miniscule, the possible consequences of a judgment to the defendant are so horrendous that these actions are almost always settled. Generally this is for a figure constituting a small fraction of the amount claimed but large enough to yield compensation to the plaintiffs' lawyers which seems inordinate even in these days of high legal fees.'' (''Federal Jurisdiction: A General View'', pp. 119-20.)

Judge Friendly also stated:

> ''The supposed justification is the contingent nature of the fee. But there is little real contingency with respect to achieving a substantial settlement once designation as a class suit has been attained in these gargantuan actions'' (*Id.* p. 120, fn. 54).

Such recognition of the real objective of the Rule 23 (b)(3) class action establishes that a plaintiff in such a class action is simply a formal vehicle to enable his counsel to achieve the objectives thus described by Judge Friendly; that such a plaintiff does not really sue to ''protect the interests of the class''; that he is not and can not be an adequate class representative of the character intended by *Hansberry* v. *Lee*; and that the action starts with both an existing and potential conflict of interest.

Such analysis by Judge Friendly is particularly apposite to the proposed settlement in this case with the principal defendants,—the six underwriters constituting the

Drexel Group,—which exemplifies the real impact of a Rule 23(b)(3) class action. Plaintiff's counsel has agreed to a settlement of $700,000 for his $110,000,000 claim, with intent to seek a $200,000 fee for himself, plus $10,000 of disbursements, for work done to the date of settlement, and a further fee for work thereafter performed. This would mean recovery of approximately $1 for each $220 lost, or about $27 for plaintiff's $6,000. The proposed payment to shareholders is less than 10% of the annual interest, which might be recoverable, based on the total claim for damages. However, plaintiff is prepared to go forward with this kind of settlement,—suggestive of the *Hansberry caveat* against "collusive sacrifice of the rights of absent parties" (311 U.S. at 45),—for both himself and the entire class he purports to represent as the allegedly adequate class representative. Since discovery was limited to subject matter jurisdiction and the related issue as to the District Court's power to bind non-resident aliens to a judgment, plaintiff's counsel made the proposed settlement before any discovery on the merits.

It is submitted that this situation,—typical of the new 1966-type "spurious" class action,—is not the kind of adequate representation which *Hansberry* prescribed as a *sine qua non* of "due process". When *Hansberry* stated that basic to a class action is that "the members of the class who are present are, *by generally recognized rules of law*, entitled to stand in judgment for those who are not" (311 U.S. at 43), it meant a person with a real personal stake in the litigation and not a lawyer who brought a class action with a nominal party plaintiff solely for his own legal fee.*

* This situation as to the new spurious class action should not be confused with the classic stockholders' derivative action, in which a plaintiff may "be a mere phantom plaintiff with interest enough to enable him to institute the action and little more" (*Koster* v. *Lumbermens Mutual Co.*, 330 U.S. 518, 525 (1947)). The basic difference is that in such stockholders' derivative action, all the parties are before the court, and there is not presented the issue of binding absent parties to a judgment, or the due process considerations inherent in Rule 23(b)(3), or the fact that expansion of the District Court's jurisdiction and its affecting substantive rights is being accomplished by rule and not by an act of Congress.

None of the three district judges through whose courtroom this case passed made any effort to decide whether plaintiff is a proper representative party, who "will fairly and adequately protect the interests of the class". It seemed ingrained that class actions are brought, not for members of the class, but for benefit of counsel.

Judge Frankel's only comment on this aspect is that plaintiff has an "energetic, competent and motivated team of counsel" (83A). But, as aptly stated in *LaMar* v. *H&B Novelty & Loan Co., supra,* 489 F.2d at 465, "There is nothing in the rule to suggest that the zeal or talent of the 'representative' plaintiff's attorney" can be used to meet the requirements of Rule 23.

Judge Ryan had no occasion to consider the issue since it was his view, which we share, that Judge Frankel "didn't enter any class order. He defined no class * * *. Therefore, what he said was dictum" (192A).

And Judge Carter merely approved a notice which, if sent, would advise all IOS shareholders that the District Court had "determined that this action may be maintained as a class action on behalf of all purchasers" in the three IOS public offerings (291A).

However, even assuming the most loyal, dedicated plaintiff; who would diligently represent all class members; who is keenly sensitive to his fiduciary obligation to the class; whose sole motivation is maximum recovery for all class members; and who, by the most rigid conceivable standards would be deemed an adequate representative, the situation is not altered. The fact still remains that, before the 1966 Amendments to Rule 23, the District Court lacked jurisdiction and power to bind to a judgment the members of a "spurious" class. The 1966 Amendments changed this, and granted the District Court sweeping power to bind to a judgment tens, thousands, or millions of persons all over the world who were members of the same kind of "spurious" class, through a "notice", lacking precision or definition. The 1966 Amendments thereby extended the "juris-

diction of the United States District Courts'' in violation of Rule 82, and did so in a manner which violates ''due process''.

Snyder v. *Harris, supra,* 394 U.S. 332 (1969), stated (p. 336) that ''the adoption of amended Rule 23 did not and could not'' make a ''change in the scope of the congressionally enacted grant of jurisdiction to the district courts.''

The decision ended on the note that (pp. 341-2):

> ''[T]he Congress that permitted the Federal Rules to go into effect was assured before doing so that none of the Rules would either expand or contract the jurisdiction of federal courts. If there is a present need to expand the jurisdiction of those courts we cannot overlook the fact that the Constitution specifically vests that power in the Congress, not in the courts''.

POINT VII

Plaintiff, an American citizen, resident of New York, is not a proper representative of a class of 100,000 persons, over 99.6% of whom consist of non-resident aliens, and the action should not be maintained as a class action.

It has already been shown that plaintiff will not pay for the cost of notice to the class ''as part of the ordinary burden of financing his own suit'', and that for this reason alone, as required by *Eisen,* the class action should be dismissed.

Second, it has also been shown that plaintiff is not a representative party who ''will fairly and adequately protect the interests of the class'', a further basis for dismissal.

Third, plaintiff's claim is not typical of the claims of the class, particularly since he bought and paid for his stock three weeks before the public offerings. As Judge

Carter noted, "plaintiff's purchase of I.O.S. shares does not appear to have been made in reliance on statements in the Crang prospectus, since that prospectus was sent to the United States after the date of purchase" (273A),—a statement equally applicable to the Drexel and IOB prospectuses.

Finally, this action is unmanageable. The mere problem of notice to 99,614 non-resident aliens, located in countries on six continents and having a variety of native tongues, alone should suffice to show unmanageability.

As observed in the American College of Trial Lawyers, Report and Recommendations of the Special Committee on Rule 23 of the Federal Rules of Civil Procedure, p. 10 (1972):*

> "Consider a class of 100,000 shareholders as plaintiffs in a securities action. Even if discovery and trial or even just the administrative processing of each claim were to consume only one hour, it would require the consumption of 100,000 hours of judicial time. Assuming the luxury seldom enjoyed by most judges of an eight hour work day and five day work week, the class action would require fifty years to conclude."

If the foregoing is true of a class of 100,000 American shareholders, *a fortiori* would it be true as to a class of comparable size, with 99,614 of its members non-resident aliens.

Furthermore, as this Court noted in *Eisen III* (479 F.2d at 1011), "the problem of manageability" and administration "includes proof of damages and the distribution of the same". It is not difficult to visualize the problems involved in the District Court's distributing a fund to the 99,614 non-resident aliens, in some 40 countries in Europe, Asia, Africa, Australia and South America.

This case does not meet the prerequisites of a class action and this Court should determine that it may not be maintained as a class action.

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* This Report was cited by the Supreme Court in *American Pipe & Construction Co.* v. *Utah, supra,* 414 U.S. 538, 555 (1974).

Conclusion

It is respectfully submitted that this Court should determine that:

(1) Judge Carter's order of December 4, 1974 constituted a determination that this action may be maintained as a class action under Rule 23(b)(3), with plaintiff as class representative, and it is an appealable order.

(2) This Court, in exercise of its supervisory control over District Courts, should set aside Judge Carter's order of December 4, 1974, as based on a champertous arrangement, made in violation of law and contrary to public policy.

(3) The Court should dismiss the action because of plaintiff's statement that he will not bear the cost of the (c)(2) notice to the class.

(4) The 99,614 non-resident aliens who purchased their IOS stock abroad cannot meet the jurisdictional requirements of a suit in the District Court, and therefore may not be members of a class subject to its jurisdiction.

(5) The Supreme Court lacked the power to prescribe Rule 23(c), as amended in 1966, since such Rule is not limited to "practice and procedure", but abridges and modifies a "substantive right", contrary to 28 U.S.C. §2072.

(6) Rule 23(c) is invalid in seeking to bind persons to a judgment anywhere in the world, by merely mailing them a notice, and also by extending the District Court's jurisdiction in violation of Rule 82.

(7) Plaintiff is not an adequate representative party; his claim is not typical; and the action is unmanageable as a class action.

Dated: New York, New York
March 21, 1975.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

- -x

HOWARD BERSCH,

Plaintiff-Appellee,

-against-

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, et al.

Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant

- -x

AFFIDAVIT OF SERVICE ON PERSON IN CHARGE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

ANTHONY MARINO, being duly sworn, says: I am employed in the office of Breed, Abbott & Morgan, 1 Chase Manhattan Plaza, New York, N.Y. 10005, attorneys for the defendant-appellant in the above action.

On the 21st day of March, , 1975, between the hours of 9:30 A.M. and 5:30 P.M., I served the annexed

BRIEF FOR DEFENDANT-APPELLANT ARTHUR ANDERSEN & CO.

on the attorney(s) listed below by delivering the same to and leaving the same with the person in charge of said office(s).

See attached list

Sworn to before me this
21st day of March, 1975

Donald L. Price

DONALD L. PRICE
NOTARY PUBLIC, State of New York
No. 24-8439300
Qualified in Kings County
Certificate Filed in New York County
Commission Expires March 30, 1976

Anthony Marino

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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HOWARD BERSCH,

Plaintiff-Appellee,

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Defendants,

ARTHUR ANDERSEN & CO.,

Defendant-Appellant

- -x

AFFIDAVIT OF SERVICE ON PERSON IN CHARGE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

LAURENCE MOLINELLI, being duly sworn, says: I am employed in the office of Breed, Abbott & Morgan, 1 Chase Manhattan Plaza, New York, N.Y. 10005, attorneys for the defendant-appellant in the above action.

On the 21st day of March, 1975, between the hours of 9:30 A.M. and 5:30 P.M., I served the annexed

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Laurence Molinelli

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